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TAGS: [EINV](#) [ECON](#) [BR](#)
SUBJECT: Brazil: PAC Investment Program Two Years Later: Mixed
Results

SENSITIVE BUT UNCLASSIFIED

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11. (SBU) Summary: The Brazilian Growth Acceleration Program ("PAC"), a government run public works program funded with federal, parastatal, and private investment, celebrated its second anniversary in February. In a recently released PAC executive summary report, the GOB highlighted past, present, and future projects while recommitting resources to the PAC despite slumping tax revenues and in view of decelerating GDP growth in Brazil. The GOB reinforced the program's objectives of modernizing Brazil's infrastructure, improving Brazil's business environment, stimulating the flow of capital, expanding Brazil's public works management capacities, and enriching the quality of life of its citizens. Despite some success in implementing a few infrastructure projects and reinvigorating the debate on tax reform, the GOB has only completed 11 percent of its planned PAC projects and critics complain of mismanagement of resources. The PAC remains a political and economic priority for Lula's Workers Party (PT) government, as well as an important deliverable for Chief of Staff Dilma Rousseff's potential presidential campaign in 2010. End Summary.

OVERVIEW

12. (U) The current consensus is for near zero percent Brazilian economic growth for 2009, and the GOB hopes that the PAC expenditures will play a key role in spurring economic growth in 12009. According to the GOB PAC report, Brazilian federal investment represented 0.64 percent of the country's GDP in 2006 prior to the creation of the PAC. In the PAC's first year (2007), investments reached 0.73 percent of GDP, and then reached one percent of GDP in 12008. Moreover, Energy parastatal Petrobras, responsible for 35 percent of PAC investments, increased the company's total investments from 0.76 percent of GDP in 2006 to 1.1 percent in 2008, with plans of reaching 1.4 percent of GDP this year.

PAC BUDGET

13. (U) President Lula announced on February 4 a 28 percent increase in PAC spending to spur economic growth, bringing the new total government and private PAC funding to R\$646 billion over the three years. (NOTE: When launched in January 2007, the PAC projected an overall investment of R\$ 503.9 billion through 2010 (or nearly US\$ 230 billion at that time). The GOB plans to invest an additional R\$ 502 billion beyond 2010. The combined PAC budget, including the three year initial budget and planned investment beyond 2010, has been allocated among the following three sectors: R\$ 132.2 billion for transportation logistics, R\$ 759 billion for energy, and R\$ 257

billion for urban and social investment. The President of the Brazilian Chamber of the Construction Industry, Paulo Safady applauded the expansion of the program, but speculated that the GOB would ultimately reallocate PAC funds for other priorities.

14. (U) However, GOB officials have asserted that PAC spending will not suffer cuts. Chief of Staff to Finance Minister Guido Mantega, Luis Melin, told Econoff that Brazil had learned from past economic crises and would not reduce infrastructure investment during the global economic downturn. Dilma Rousseff echoed Melin's comments indicating that the GOB intended to use PAC spending as an anti-cyclical measure to mitigate the crisis. Rousseff indicated in an interview with Brazil's national economic newspaper Valor that the crisis is transforming the PAC into a mechanism to combat the turbulence. Likewise, Planning Minister Paulo Bernardo stated that all PAC investment would be maintained, and, if budget cuts were needed, the PAC would not be affected.

PAC BUDGET EXECUTION WEAK

15. (U) According to the Federal Budget Secretariat of the Ministry of Planning, the GOB had actually programmed only R\$ 68 billion at the inception of the PAC, and then increased to R\$ 73 billion after the program was expanded in February 2009. Although the GOB authorized R\$ 33 billion in investments over the last two years, only R\$ 18.7 billion was effectively disbursed, representing less than 30 percent of the total programmed budget amount (R\$ 73 billion) since 2007. However, the GOB increased its disbursements in 2008; the amount disbursed in 2008, R\$ 11.4 billion, was 55 percent greater than in 2007. In highlighting the challenges the GOB faces in effectively disbursing authorized PAC money, national

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newspaper O Estado De Sao Paulo reported in a March 16 article that the year to date PAC expenditures amounted to only 5.2 percent of the annual authorized budget amount of R\$ 20.7 billion, and that up to March 12, daily PAC expenditures in 2009 were 45 percent lower than in 2008.

16. (U) A number of factors explain the slow disbursement of PAC funds, such as cumbersome environmental licensing and various Federal Accounting Court (TCU) investigations. Of the 2,378 PAC projects that the PAC Management Committee (Planning Ministry, Finance Ministry and Planalto) currently monitors, only 190 have received environmental licenses from the Ministry of the Environment. The TCU, charged with ensuring contract transparency and financial oversight, has audited 124 works for potential contract irregularities, of which 69 have to date been "released" to proceed.

PAC PERFORMANCE: RESULTS IN 2025?

17. (U) Excluding sanitation and housing projects, the number of projects that the PAC Management Committee currently monitors has increased from 2,198 in September 2008 to 2,378 in December 2008. Of these works, 11 percent, or 270 projects, have been concluded, corresponding to an investment of R\$ 48.3 billion or nearly 2 percent of GDP. The GOB lists the construction of 4,300 km of roads and 240 km of railroads, the refurbishment of airports, ports and waterways, subways, and the establishment of electrical, water, and sewage networks throughout the country as the main PAC achievements to date in the logistics and social-urban sectors. In the energy sector, highlights include expanding generation capacity by 2,600 MW, installing 4,100 km of transmission lines, building 1,400 km of pipelines, and refurbishing shipyards and merchant marine vessels.

18. (U) Despite these achievements, the GOB is far behind on its goals of project completion. At the current pace, the remaining 89 percent of ongoing projects would be concluded around 2025. The President of the Union of Heavy Construction Industry (Sindicon), Luiz Fernando Reis, criticized the GOB bureaucracy for impeding budget execution of PAC funds and the GOB's poor project management skills. In response, the GOB claims that 80 percent of the

unfinished projects are being executed at an "adequate pace", while 7 percent require "attention" and only 2 percent are "worrisome." Of the projects moving at an "adequate pace," 58 percent are currently under construction, 20 percent are in the bidding process, and 11 percent are in the analysis or licensing phase.

PAC RELATED INSTITUTIONAL REFORMS

¶9. (U) The introduction of the PAC has facilitated several legislative initiatives designed to enhance the GOB's public works management capacities and improve Brazil's business and investment climate. Examples include tax facilitation measures such as the 2007 General Law of Small Business, tax exemptions for the civil construction sector, and the controversial Tax Reform bill that is currently under debate in Congress. Congress has also proposed credit stimulus measures such as the expansion of Brazil's National Developmental Bank (BNDES) credit operations, the reduction in interest rates and the creation of an Investment Fund utilizing resources from the FGTS (a federal labor fund sourced by employers). Measures to improve the investment climate include a new regulatory framework for the sanitation sector passed in 2007, and the Natural Gas Law approved last month. In addition, there are two proposals for a new regulatory framework for inter-agency collaboration and a new Brazilian system for competition enforcement, both awaiting Congressional action. Management measures include a new regime for public sector social security under debate in Congress, the 2007 Decree that improves transparency of the management of parastatal companies, and the creation of career federal infrastructure analysts, of which, 516 analyst and 84 specialist positions have been filled. Long-term fiscal measures pending Congressional approval include efforts to cap the expansion of the Federal payroll and enhanced facilitation and transparency of the project bidding process.

COMMENT

¶10. (SBU) Although the pace of project completion has been slow, due in some part to bureaucratic licensing obstacles and contracting oversight issues, the GOB continues to point to the program as an

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important anti-cyclical fiscal stimulus that mitigates the effects of the global downturn. The PAC program infrastructure investments are regarded as a key component in promoting President Lula's Chief of Staff, Dilma Rousseff, as his likely successor as the PT candidate for the 2010 elections. Dilma is noticeably present at the inauguration ceremonies of most PAC projects. Given the political imperatives of the PAC, the program (along with the Bolsa Familia welfare program and healthcare spending) is likely to remain a budget priority for the GOB.

¶11. (SBU) 2007 and 2008 were the first years since the 1980s that Brazilian growth topped five percent in two consecutive years. While the GOB touts the PAC as one of the primary contributors to pushing GDP growth above five percent the last two years, and as an important stimulus to growth in light of the global crisis, its actual impact appears slight to date and could take years to measurably increase economic growth. The slow pace of budget execution and disbursement of funds probably will continue to delay PAC project execution. Despite the GOB's pledges to maintain PAC investments, if tax receipts continue to fall, Lula will be hard pressed to find the right balance between economic and political expediency. Furthermore, the PAC is likely to attract increased scrutiny and criticism if the program is perceived as failing to boost economic growth in 2009. End Comment.

¶12. (U) This cable has been coordinated with Consulate Sao Paulo.

KUBISKE